ALAM MARITIM (M) SDN BHD

v.

LEMBAGA HASIL DALAM NEGERI MALAYSIA

HIGH COURT MALAYA, KUALA LUMPUR
AZIAH ALI J
[JUDICIAL REVIEW NO: R1-22-148-2007]
31 MARCH 2010

ADMINISTRATIVE LAW: *Remedies - Certiorari - Application to quash respondent's decision that applicant was obliged to deduct withholding tax on payment of charter fees made to Singapore non-resident companies - Whether Singapore enterprise was carrying on business in Malaysia through a permanent establishment - Whether art. IV of Double Taxation Agreement applicable - Whether there was legal basis for respondent to impose income tax on Singapore non-resident companies*

REVENUE LAW: *Income tax - Obligation to deduct withholding tax - Whether applicant duty bound to make or deduct any withholding tax in relation to charter fees made to Singaporean non-resident companies - Whether Singapore enterprise was carrying on business in Malaysia through a permanent establishment - Whether art. IV of Double Taxation Agreement applicable - Whether there was legal basis for respondent to impose income tax on Singapore non-resident companies*

The applicant applied for an order of *certiorari* to quash the decision of the respondent that pursuant to s. 109B of the Income Tax Act 1967 ('the ITA'), the applicant was obliged to deduct withholding tax on the payment of charter fees made by the applicant between 1998 - 2004 to Singaporean non-resident companies operating the business of the supply of ship and crew or 'time charter' of ship and crew ('Time Charter Services'). The applicant contended that as the respondent had classified the payment of charter fees made by the applicant as coming within the provisions of s. 4A (iii) of the ITA, such payments constitute the 'business income' of the Singaporean non-resident companies and therefore art. IV of the 'Double Taxation Agreement' ('the DTA') applied. The applicant stated that the non-resident service provider companies were from countries which had entered into avoidance of double taxation treaties and that art. IV of the DTA

afforded relief from taxation to the Singaporean resident service provider. Hence, it was the applicant's case that there was no legal basis for the respondent to impose income tax on these non-resident companies and therefore the applicant was not duty bound to make or deduct any withholding tax in relation to the charter fees. The respondent, however, contended that the facts showed that the applicant had hired ship or vessels from the non-resident companies and therefore the applicant had used the vessels owned by the non-resident companies. The respondent submitted that the facts were in line with the provisions of s. 4(iii) of the ITA and as payment was made to non-resident companies therefore the payment fell within the provisions of s. 109B of the ITA and art. IV of the DTA did not apply.

Held (allowing the application):

(1) There was no dispute that the non-resident companies operate the business of 'time charter' of ship and crew for the supply of ships with crew. The applicant had no issue with the respondent's stand that the charter fees paid by the applicant came within the provisions of s. 4A(iii). In respect of the nature of the income, on the evidence, the charter fees were 'business income' of the Singaporean non-resident companies (*Walter Wright (Singapore) Pte Ltd v. Director General of Inland Revenue*). (para 12)

(2) The words of art. IV are clear. The article affirmatively states that income or profits of a Singapore enterprise shall not be taxable in Malaysia unless such Singapore enterprise carries on a business in Malaysia through a permanent establishment situated in Malaysia. Liability of the Singapore enterprise to Malaysian tax is predicated on whether or not the Singapore enterprise has a permanent establishment in Malaysia. If the condition precedent in art. IV is satisfied, no tax may be imposed in Malaysia as expressly provided for in the DTA which prevails over the ITA. (para 15)

(3) Once it was established that the Singapore enterprise does not maintain a permanent establishment in Malaysia, which in this case the respondent conceded, then the income or profits of the Singapore enterprise shall not be taxable in Malaysia. Herein, the charter fees paid by the applicant which was

business income for the Singapore non-resident companies were not subject to the ITA. There was no legal basis for the respondent to impose income tax on these Singapore non-resident companies. Consequently, the applicant was not duty bound to make or deduct any withholding tax in relation to the charter fees. (para 16)

Case(s) referred to:
Hock Heng Company Sdn Bhd v. Director-General of Inland Revenue [1979] 1 LNS 30 PC ***(refd)***
Oil Asia Pte Ltd v. Ketua Pengarah Hasil Dalam Negeri [1996] MSTC 2752 ***(refd)***
Walter Wright (Singapore) Pte Ltd v. Director-General Of Inland Revenue [1990] 2 CLJ 137; [1990] 3 CLJ (Rep) 335 HC ***(refd)***
WW(S) PL v. DGIR [1988] 1 MTC 282 ***(refd)***

Legislation referred to:
Finance Act 1983, s. 5
Income Tax Act 1967, ss. 4A(iii), 109B, 132

Double Taxation Relief Order of 1968 [Sing], arts. IV, VXIII

For the applicant - R Thilakan; M/s Thilakan & Co
For the respondent - Noorhisham Ahmad; FC

Reported by Suhainah Wahiduddin

JUDGMENT

Aziah Ali J:

[1] The applicant applies for an order of *certiorari* to quash the decision of the respondent made by a letter dated 21 May 2007 that pursuant to s. 109B of the Income Tax Act 1967 ("the ITA"), the applicant is obliged to deduct withholding tax on the payment of charter fees made by the applicant between 1998-2004 to Singaporean non-resident companies operating the business of the supply of ship and crew or "time charter" of ship and crew ("Time Charter Services"). It is the respondent's contention that the payments received by the non-resident companies come within the 'Special Classes of Income' under s. 4A(iii) of the ITA and is thus subject to withholding tax under s. 109B of the said Act.

[2] The applicant contends that the respondent:

(a) has failed to give effect to the objective, spirit and intent of the ITA read in conjunction with each of the avoidance of double taxation agreements;

(b) has failed to take into account relevant matters;

(c) is mistaken from the perspective of the law and the facts;

(d) has offended the principles of procedural and substantive justice, specifically for failure to obtain clarification or further evidence from the applicant before issuing its final decision which is unsubstantiated.

In essence the applicant contends that as the respondent has classified the payment of charter fees made by the applicant as coming within the provisions of s. 4A(iii) of the ITA, such payments constitute the 'business income' of the Singaporean non-resident companies and therefore art. IV of the 'Double Taxation Agreement' ("the DTA") applies.

[3] The applicant says that the decision of the respondent *vide* its letter dated 21 May 2007 is incorrect, or unfair and is perverse and arrived at without or exceeding the jurisdiction in circumstances any reasonable body would not have reached the same decision. The respondent on the other hand contends that art. IV of the DTA does not apply to this case.

Background

[4] The applicant is a private company whose main activities are the ownership of vessels and the provision of vessel hire and management. For the period from 1998 till 2004, the period which is the subject matter of this application, the applicant entered into "Uniform Time Charter Party for Offshore Service Vessels" contracts, which pertain to the payment of charter fees for the supply of ships with crew in the form of services, with non-resident companies operating the business of "time charter" of ship and crew (encl. 3 exh. "AM1"). None of these non-resident companies have a permanent establishment in Malaysia. Throughout the duration of the said period, these non-resident companies received to account of their business income, payment in full for such charter fees from the applicant without withholding tax for the time charter services rendered during the said period.

The Applicant's case

[5] The applicant states that the non-resident service provider companies were from countries which had entered into avoidance of double taxation treaties which had been given legal force and effect by orders of the Minister. It is contended that the charter fees paid by the applicant accrued as the business income of these Singaporean resident service providers (*Oil Asia Pte Ltd v. Ketua Pengarah Hasil Dalam Negeri* [1996] MSTC 2752; *WW(S) PL v. DGIR* [1988] 1 MTC 282). The income derived by the Singapore resident companies with no permanent establishment in Malaysia in the form of charter fees constitutes the "business income" of these Singaporean companies and taxable in their country of residence.

[6] The applicant contends that once the respondent categorises the charter fees paid as coming within the provisions of s. 4(iii) of ITA, then the respondent ought to refer to the 'Malaysia-Singapore Double Taxation Avoidance Agreement' ("the DTA") and 'Double Taxation Relief (Singapore) Order 1973 ("the order") to determine whether relief from taxation has been provided. It is the applicant's contention that art. IV of the DTA afforded relief from taxation to the Singaporean resident service provider. It is submitted that by s. 132 of ITA, the provisions of the avoidance of double taxation treaties take precedence over the ITA. Hence the applicant is not obliged at all to make deductions of withholding tax in respect of the payments to the said non-resident companies with the relief from double taxation afforded to these non-resident companies in Malaysia. The applicant submits that there is no legal basis for the respondent to impose income tax on these non-resident companies and therefore the applicant is not duty bound to make or deduct any withholding tax in relation to the charter fees.

The Respondent's Case

[7] For the respondent it is contended that the facts show that the applicant deals with the supply service and managing shipping together with supplying crews. The ship or vessels were hired from the non resident companies and therefore the applicant had used the vessels (moveable property) owned by the non resident companies. The respondent submits that the facts are in line with the provisions of s. 4(iii) of the ITA ie, "rent or other payments

made under any agreement or arrangement for the use of any moveable property," and as payment is made to non-resident companies therefore the payment falls within the provisions of s. 109B of the ITA.

[8] The respondent says that by s. 5 of the Finance Act 1983 ("Act 293") which is deemed to come into force on 21 October 1983, the ITA was amended to include the new s. 4A and the intention of Parliament in enacting s. 4A of the ITA is to tax certain classes of income of non resident which is derived from Malaysia and s. 109B provides for the mechanism to withhold the tax of the non resident. The respondent submits that art. VXIII of the DTA confers taxing rights between two contracting states and affords relief from double taxation to reduce the tax suffered by a resident company. Article VXIII provides as follows:

> The laws of Malaysia shall continue to govern the taxation of income derived from Malaysia except where express provision to the contrary is made in this Agreement ...

[9] Article IV provides that the Government of Malaysia may tax the income or profits of a Singapore enterprise through its permanent establishment in Malaysia. Article IV 1(a) provides as follows:

Article IV

> The income or profits of a Singapore enterprise shall not be taxable in Malaysia **unless the enterprise carries on business in Malaysia through a permanent establishment situated in Malaysia**. If the enterprise carries on business **as aforesaid**, tax may be imposed in Malaysia on the income or profits of the enterprise but only on so much thereof as is derived by that permanent establishment in Malaysia. (emphasis added)

It is the respondent's contention that art. IV refers to the enterprise which has a permanent establishment in Malaysia, and as the non-resident companies do not have any permanent establishment in Malaysia therefore art. IV does not apply. The respondent refers to the case of *Hock Heng Company Sdn Bhd v. Director-General of Inland Revenue* [1979] 1 LNS 30 which is a case where the appellant taxpayer is a company incorporated and resident in Malaysia. In 1968 the company derived an income of $31,415 in Malaysia but suffered a loss in that year of $538,335

on the operations of its branch in Singapore. In respect of art. IV of the Double Taxation Relief Order of 1966, the Privy Council found that "The taxpayer company is a Malaysian enterprise and it carries on business in Singapore through a permanent establishment, so this article applies to it. If any profits are made by that establishment, they are taxable only in Singapore. They are not, whether or not remitted to Malaysia, taxable in Malaysia." The Privy Council said:

> Paragraph 1 of this Article is, however, important and, in their Lordships' opinion, determinative of the appeal. The laws of Malaysia are to continue to govern the taxation of income in that state except where express provision to the contrary is made in the agreement.

[10] The respondent submits that the nature of income received by the non-resident company and the law which taxes the income received by a non-resident company has to be determined (*Walter Wright (Singapore) Pte Ltd v. Director-General Of Inland Revenue* [1990] 2 CLJ 137; [1990] 3 CLJ (Rep) 335). It is submitted that the income received by a non-resident company is caught by s. 4A(iii) and by s. 24(8) the provisions of s. 28 do not apply. Therefore nothing in the DTA prevents the application of s. 4A of the ITA in this case. The respondent contends art. IV does not apply.

Decision

[11] The applicant submits that the charter fees payable by the applicant to the Singaporean non-resident service providers and categorized by the respondent as coming within the provisions of s. 4(iii) of ITA are the business income of the non-resident service provider. Therefore art. IV of the DTA afforded relief from taxation to the Singapore resident service provider and the applicant is not duty bound to make or deduct any withholding tax in relation to the charter fees. The respondent on the other hand contends that as the payments come within s. 4A and hence the provisions of s. 109B ITA apply. The respondent contends art. IV of the DTA does not apply.

[12] Section 4A. ITA provides as follows:

A Special classes of income on which tax is chargeable

4A. Notwithstanding the provisions of section 4 and subject to this Act, the income of a person not resident in Malaysia for the basis year for a year of assessment In respect of:

B (i) ..

(ii) ...

(iii) rent or other payments made under any agreement or arrangement for the use of any moveable property,

C which is derived from Malaysia is chargeable to tax under this Act.

There appears to be no dispute that the non-resident companies operate the business of "time charter" of ship and crew for the D supply of ships with crew. The applicant has no issue with the respondent's stand that the charter fees paid by the applicant come within the provisions of s. 4A(iii). The applicant says for the non-resident companies the nature of the income is 'business income'. In respect of the nature of the income, on the evidence E I agree with the applicant that the charter fees are 'business income' of the Singaporean non-resident companies (*Walter Wright (Singapore) Pte Ltd v. Director General of Inland Revenue*, *supra*).

[13] Having determined the nature of the income, the issue is F whether art. IV of the DTA applies as contended by the applicant, or s. 109B of ITA applies as contended by the respondent. The applicant takes the stand that once the charter fees fall within the category of income under s. 4A and since the non-resident service providers being Singaporeans, Article IV of G the DTA applies to the exclusion of s. 109B of ITA which provides as follows:

Deduction of tax from special classes of income in certain cases derived from Malaysia

H 109B. (1) Where any person (in this section referred to as "the payer") is liable to make payments to a non-resident:

(a) for services rendered by the non-resident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, I machinery or other apparatus purchased from, such non-resident;

(b) for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or

(c) for rent or other payments made under any agreement or arrangement for the use of any moveable property,

which is deemed to be derived from Malaysia, he shall, upon paying or crediting the payments, deduct therefrom tax at the rate applicable to such payments, and (whether or not that tax is so deducted) shall within one month after paying or crediting such payment, render an account and pay the amount of that tax to the Director General:

[14] Section 109B of the ITA expressly provides that where a person is liable to make payments to a non-resident for rent or other payments under any agreement or arrangement for the use of moveable property, and such rent or other payments are deemed to be derived from Malaysia, then such person shall deduct from such payment tax at the rate applicable and subsequently pay such amount to the Director General. Section 4A of ITA provides that the income of a person not resident in Malaysia in respect of such rent or other payments made under any agreement or arrangement for the use of any moveable property which is derived from Malaysia is chargeable to tax under ITA. The respondent submits that art. IV does not apply because as submitted by counsel "the said article means that the Government of Malaysia may tax business through a permanent establishment in Malaysia. Only then art. IV of the DTA applies." (see para. 30 of the respondent's written submissions).

[15] Article IV provides as follows:

Article IV

1.(a) income or profits of a Singapore enterprise shall not be taxable in Malaysia **unless the enterprise carries on business in Malaysia through a permanent establishment situated in Malaysia**. If the enterprise carries on business as aforesaid, tax may be imposed in Malaysia on the income or profits of the enterprise but only on so much thereof as is derived by that permanent establishment in Malaysia. (emphasis added)

(b) ...

The words of art. IV are clear. The article affirmatively states that income or profits of a Singapore enterprise shall not be taxable in Malaysia unless such Singapore enterprise carries on a business in Malaysia through a permanent establishment situated in Malaysia. Liability of the Singapore enterprise to Malaysian tax is predicated on whether or not the Singapore enterprise has a permanent establishment in Malaysia. If the condition precedent in Article IV is satisfied, no tax may be imposed in Malaysia as expressly provided for in the DTA which prevails over the ITA.

[16] In the Privy Council case of *Hock Heng Company Sdn Bhd v. D.G.I.R (supra)* the appellant taxpayer is a company incorporated and resident in Malaysia. The business of the company consists of hiring out of cranes and trucks in Malaysia and is its 'lifeblood'. In 1968 the company had an income of $31,415 derived in Malaysia but suffered a loss of $538,335 on the operations of its branch in Singapore. The Privy Council found that under Malaysian domestic law (ITA) the rental income of the taxpayer is business income and not only rental income. With respect to art. IV of the Double Taxation Relief (Singapore) Order of 1968 the Privy Council said:

> ... under Article IV only a Singapore enterprise which maintains a permanent establishment in Malaysia is subject to Malaysian income tax.

Therefore in respect of art. IV the test to be applied is whether or not the Singapore non-resident enterprise maintains a permanent establishment in Malaysia. Once it is established that the Singapore enterprise does not maintain a permanent establishment in Malaysia, which in this case the respondent concedes, then the income or profits of the Singapore enterprise shall not be taxable in Malaysia. On the question of which law prevails ie, the DTA which is made under s. 132 of ITA, or ITA, the Privy Council in *Hock Heng*'s case said:

> The laws of Malaysia are to continue to govern the taxation of income in that state except where express provision to the contrary is made in the agreement.

On the facts of this case I find that the charter fees paid by the applicant which is business income for the Singapore non-resident companies are not subject to the ITA. For the aforementioned reasons I agree with the applicant that there is no legal basis for the respondent to impose income tax on these Singapore non-resident companies. Consequently the applicant is not duty bound to make or deduct any withholding tax in relation to the charter fees. The application is allowed with costs of RM3,000 to the applicant.